

CORPORATE GOVERNANCE AND FINANCIAL GLOBALIZATION

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Abstract: At the global level, governance has been viewed primarily as intergovernmental relationships, but it must now be understood as also involving non-governmental organizations, citizen's movements, multinational corporations, and the global capital market. Therefore it should be analyzed how corporate governance might affect global strategy and global organization, which in turn will shape the patterns of globalization. Also, it should be done a theoretical analysis regarding how each corporate governance actor (employees, shareholders, the board of directors, top management, teams and governments) will behave towards global strategy.

Keywords: corporate governance, globalization, corporations, stakeholders.

Introduction

With the globalization of the world's capital markets, corporate governance has followed swiftly onto the world stage. Furthermore, global forces are shaping the continuing development of corporate governance, and institutional investors, with their expanding cross-market holdings, have become agents for change.

The importance of corporate governance is hardly limited to Anglo-American markets. In fact, the investors share strong views on the value of corporate governance regardless of their region. The adoption of a common European currency, the freer flow of capital, goods, services and people across EU borders, and increased merger activity among large European companies have all created tremendous interest among European issuers and investors, member states and the Commission in the shared aims, as well as the differences, in corporate governance practice across Europe (reflected in corporate governance codes) and also any related barriers to the development of a single EU financial market.

Globalizing forces exert a pull that shapes and accelerates the development of corporate governance in markets throughout the world. The introduction of corporate governance regulations and best practices in one country or region (such as the European Union) increasingly affects practices in markets far beyond those borders.

Momentum is also global. For the majority of investors the corporate governance is more important today than it was three years ago and will become even more important in the next three years.

At the global level, governance has been viewed primarily as intergovernmental relationships, but it must now be understood as also involving non-governmental organizations, citizen's movements, multinational corporations, and the global capital market.

What Exactly Is Corporate Governance?

Corporate governance is the set of processes, customs, policies, laws and institutions affecting the way a corporation is directed, administered or controlled. Narrowly defined, corporate governance concerns the relationships among the many players involved (*the stakeholders*) and the goals for which the corporation is governed. The principal players are the shareholders, management and the board of directors. Other stakeholders include employees, suppliers, customers, banks and other lenders, regulators, the environment and the community at large.

More broadly defined, corporate governance can encompass the combination of laws, regulations, listing rules and voluntary private sector practices that enable the corporation to:

- attract capital;
- perform efficiently;
- achieve the corporate objective;
- meet both legal obligations and general societal expectations.

The Commission on Global Governance (United Nations) defines Global Governance as “the sum of the many ways individuals and institutions, public and private, manage their common affairs“. It is a continuing process through which conflicting or diverse interests may accommodate, and cooperative action may be taken. It includes formal institutions and regimes empowered to enforce compliance, as well as informal arrangements that people and institutions either have agreed to or perceive to be in their interest.

Corporate governance is a multi-faceted subject. An important theme of corporate governance deals with issues of accountability and fiduciary duty, essentially advocating the implementation of guidelines and mechanisms to ensure good behavior and protect shareholders. Another key focus is the economic efficiency view, through which the corporate governance system should aim to optimize economic results, with a strong emphasis on shareholders welfare. There are yet other sides to the corporate governance subject, such as the stakeholder view, which calls for more attention and accountability to players other than the shareholders.

In corporations, the shareholder delegates decision rights to the manager to act in the principal's best interests. This separation of ownership from control implies a loss of effective control by shareholders over managerial decisions. Partly as a result of this separation between the two parties, a system of corporate governance controls is implemented to assist in aligning the incentives of managers with those of shareholders.

A board of directors often plays a key role in corporate governance. It is their responsibility to endorse the organization's strategy, develop directional policy, appoint, supervise and remunerate senior executives and to ensure accountability of the organization to its owners and authorities.

All parties to corporate governance have an interest, whether direct or indirect, in the effective performance of the organization. Directors, workers and management receive salaries, benefits and reputation, while shareholders receive capital return. Customers receive goods and services; suppliers receive compensation for their goods or services. In return these individuals provide value in the form of natural, human, social and other forms of capital.

Numerous corporate governance principles and codes have been developed in different countries and issued from stock exchanges, corporations, institutional investors, or associations (institutes) of directors and managers with the support of

governments and international organizations. Commonly accepted principles of corporate governance include:

- *Rights and equitable treatment of shareholders:* organizations should respect the rights of shareholders and help shareholders to exercise those rights. They can help shareholders exercise their rights by effectively communicating information that is understandable and accessible and encouraging shareholders to participate in general meetings.
- *Interests of other stakeholders:* organizations should recognize that they have legal and other obligations to all legitimate stakeholders.
- *Role and responsibilities of the board:* the board needs a range of skills and understanding to be able to deal with various business issues and have the ability to review and challenge management performance.
- *Integrity and ethical behavior:* organizations should develop a code of conduct for their directors and executives that promotes ethical and responsible decision making.
- *Disclosure and transparency:* organizations should clarify and make publicly known the roles and responsibilities of board and management to provide shareholders with a level of accountability. They should also implement procedures to independently verify and safeguard the integrity of the company's financial reporting.

Different governance systems articulate the corporate objective in different ways, depending on which of two primary concerns is taken as the main focus: societal expectation or ownership rights.

Some nations focus on the need to satisfy societal expectations and, in particular, the interests of employees and other stakeholders (variously defined to include suppliers, creditors, tax authorities and the communities in which corporations operate). This view predominates in continental Europe (particularly Germany, France and The Netherlands) and in certain countries in Asia.

Other countries emphasize the primacy of ownership and property rights, and focus the corporate objective on returning a profit to shareholders over the long term. Under this view, employees, suppliers and other creditors have contractual claims on the company. As owners with property rights, shareholders have a claim to whatever is left after all contractual claimants have been paid. Associated with the US, Canada, the UK and Australia, this view of the corporate governance objective is generally justified on the followings:

- accountability to shareholders provides a single measurable objective that avoids the risk of diffusing the accountability of managers and directors. If managers and directors are accountable to a whole range of stakeholders, almost any action can be justified as in the interest of some group of stakeholders, and this gives managers and directors unfettered discretion;
- focusing on long-term shareholder value encourages investment capital to be put to the most efficient economic use from a market perspective and this should benefit society broadly.

No matter what view of the corporate objective is taken, effective governance ensures that boards and managers are accountable for pursuing it. The role of corporate governance in making sure that board and management are accountable is of broad importance to society for a number of reasons. An effective corporate governance system:

- promotes the efficient use of resources both within the company and the larger economy. Debt and equity capital should flow to those corporations capable of investing it in the most efficient manner for the production of goods and services most in demand, and with the highest rate of return. In this regard, effective governance should help protect and grow scarce resources, therefore helping to ensure that societal needs are met. In addition, effective governance should make it more likely that managers who do not put scarce resources to efficient use, or who are incompetent or (at the extreme) corrupt, are replaced.

- assists companies (and economies) in attracting lower-cost investment capital by improving both domestic and international investor confidence that assets will be used as agreed (whether that investment is in the form of debt or equity). Although managers need to have latitude for discretionary action if they are to innovate and drive the corporation to compete successfully, rules and procedures are needed to protect capital providers, including: independent monitoring of management; transparency as to corporate performance, ownership and control; participation in certain fundamental decisions by shareholders.

- assists in making sure that the company is in compliance with the laws, regulations and expectations of society. Effective governance involves the board of directors ensuring legal compliance and making judgments about activities that, while technically lawful in the countries in which the company operates, may raise political, social or public relations concerns.

- provides managers with oversight of their use of corporate assets. Corporate governance may not guarantee improved corporate performance at the individual company level, as there are too many other factors that impact on performance. But it should make it more likely for the company to respond rapidly to changes in business environment, crisis and the inevitable periods of decline. It should help guard against managerial complacency and keep managers focused on improving firm performance, making sure that they are replaced when they fail to do so.

- is closely related to efforts to reduce corruption in business dealings. Although it may not prevent corruption, effective governance should make it more difficult for corrupt practices to develop and take root, and more likely that corrupt practices are discovered early and eliminated. Effective governance is a check on the power of the relatively few individuals within the corporation who control large amounts of other people's money.

Roles of Corporate Governance's Actors in Globalization

The corporate governance is conceptualized broadly as the *set of interests and practices undertaken by shareholders and stakeholders of the firm*. The focus should be on how the main governance actors (employees, shareholders, the board of directors, top management teams, and government) behave towards the firm as representative of the different interests shaping firm strategy. These interests are not always aligned.

Existing frameworks for globalization usually have three constructs: industry globalization drivers, global strategy elements and global organization factors. Government drivers are frequently included under industry aspects, but focus on inter-country rules such as trade and foreign direct investment regimes. But these government drivers of globalization ignore intra-country rules in terms of governance.

Corporate governance is likely to affect all aspects of global integration which can be grouped in the following categories:

- the elements of *global strategy*: global market participation, global products and services, global activity location, global marketing and global competitive moves;
- the elements of *global organization*: global organization structure, global management processes, global human resources and global culture.

Therefore it is important to know how corporate governance might affect global strategy and global organization, which in turn will shape the patterns of globalization and also, how particular aspects of corporate governance (as related to actors in corporate governance within an institutional context) affect globalization outcomes.

It should be done a theoretical analysis to explain the logic that could predict how each corporate governance actor will behave towards global strategy and global organization that in turn will lead to a particular pattern of globalization mode.

a) Employees

The role of home country employees in corporate governance varies by country, as determined by the existing institutional arrangements.

Employees can have different mechanisms for influencing firm governance, depending on the corporate governance regime in which they operate. Examples of employee voice are board representation, work councils, equity ownership, unions, consultation rights and rules on working conditions and job security. The capacity of employees' to influence the firm will have important effects for the firm's ability to undertake global strategy and organization.

Regarding the strategy dimensions of global integration, a strong corporate governance role for employees should be favorable to *global market participation*, as this latter applies to the global expansion of sales and therefore should favor home employment rather than threaten it.

Similarly, the strong involvement of labour in firm governance shapes the characteristics of global products and services. A successful *global product strategy* requires not just the right design but also the ability to manufacture to world-class standards. Companies based in countries that for whatever reason cannot produce to world-class standards will, therefore, find it hard to adopt a global product strategy. On the other hand, too much employee involvement can have deleterious effects on product or service quality.

Conversely, employees having a strong position within the firm's corporate governance should:

- make it harder for a corporation to relocate activities globally outside the home country;
- have a small negative effect on the use of global marketing, at the margin, strong home country employees may prefer marketing that retains national identity;
- make it harder for a corporation to make global competitive moves, as these often require sacrifice of home country position, resources, revenues or profits, and hence domestic jobs or working conditions.

Regarding the effects on global organization, it would expect that employees having a strong corporate governance role will not favor any global strategy lever because they would contribute to either fewer home country jobs or to decrease the quality of home country jobs. For instance, the implementation of global human resource policies is likely to transplant jobs across different subsidiaries and to introduce efficiency policies that are likely to impoverish home country employment practices such as work organization or performance incentives.

b) Shareholders

Shareholders of large public multinational corporations play differing roles in different countries. There can be differentiate the *neutral shareholders* and those with *vested interests (partial)*. The neutral shareholders are the ones to concern to maximize profits and shareholder value. USA and the UK have mostly neutral shareholders, who are focused on maximization of shareholder value.

Interested shareholders also care about other objectives, sometimes ahead of shareholder value. Employee shareholders nearly always have the partial interest of some bias against maximizing shareholder value in favor of employment levels, pay or conditions. The shareholders such as banks or institutional investors are considered as partial interest shareholders, as they will have several interests at stake in addition to shareholder value maximization. In Japan, institutional shareholders hold maintenance of the overall network as a major objective. In Germany, institutional shareholders typically have close ties and loyalty to management. In all countries, state shareholders pursue additional objectives such as maintaining employment, national security, competitiveness and prestige.

For short, neutrality or partiality is a function of several shareholder attributes: the typical roles in a country of institutional shareholders and of governmental shareholders, the prevalence of first versus second or later generation family shareholders, the extent of shareholdings by managers and lastly the degree of concentration that will allow the exercise of shareholder influence. Hence is important to use neutrality versus partiality of shareholder interests as the key defining characteristic of shareholder behavior that affects globalization, although partial shareholders will need some degree of concentrated ownership in order to exercise influence.

It is expected that shareholders will manifest different positions regarding the five global strategy levers. First, most shareholders, whether neutral or partial, should be in favor of *global market participation*, as that usually helps rather than affect domestic interests such as higher firm revenues.

Second, whether shareholders are neutral or partial probably has little effect on the ability of corporations to produce *globally competitive products and services*. For example, Japan and Germany produce on average the highest quality global products and have similar types of shareholder interests (large institutions that favor incumbent management and the status quo). France and Italy have relatively large shareholdings by partial government shareholders but are not as successful in producing global products except in some niche areas. The USA and UK have similar corporate governance in terms of having mostly neutral shareholders. But the USA has many more companies with successful global products while Britain has almost no global products left, but a significant number of globally competitive services (especially in finance, airlines and creative industries).

Third, neutral shareholders should favor *global relocation of activities* if that is in the best interests of the company and ultimately shareholder value. Some types of partial shareholders may oppose global relocation; in particular, significant equity ownership by home country employees makes it difficult for companies to move jobs overseas. Many government shareholders also seek to protect domestic employment. Some family shareholders may also have sentimental or altruistic reasons for preserving domestic employment.

Fourth, partial shareholders should have a small negative effect on the use of *global marketing*. At the margin, some home country shareholders, such as employees and governments, may prefer marketing that retains national identity. Second and later generation family shareholders may also seek to preserve a company heritage that has a national identity.

Finally, partial shareholders with home country interests, such as employees and governments, should make it harder for a company to make *global competitive moves*, as these often require sacrifice of home country position, resources, revenues or profits, and hence domestic jobs or working conditions.

The existing literature provides little guidance on the relationship between shareholder interests and global organization. First, even partial shareholders with domestic interests should favor *global organization structures* so long as the home country is dominant. An exception is that state owners may favor country-based organization structures, or a domestic-international split in order to preserve home country jobs, investment, or influence. A change from national family ownership to foreign or neutral ownership can trigger reorganization toward a global structure. Second, partial shareholders should favor *global management processes* so long as the home country processes dominate. Third, some types of partial shareholders, especially employees, should make it harder for a company to have *global human resource policies*, as they will favor the employment and advancement of home country nationals. Finally, firms controlled by family shareholders and domestic employee shareholders may find it hard to create a *global culture*.

c) Board of directors

Boards of directors vary importantly in terms of their structure, composition and activeness. German boards have a dual structure, with a supervisory board above a management board. The supervisory board has various statutory duties, particularly the appointment of the members of the management board and supervision of their actions. In the UK, most boards adhere to the Cadbury Report's recommendation of having a non-executive chairman; in the other countries, the roles of chief executive (CEO) and chairman are often combined, especially in the USA. Another aspect of board structure is the role of committees, which varies depending on the strategic leadership of the board.

The composition of boards in major OECD countries varies by both custom and law. British boards have a high proportion, usually a majority, of corporate executives, with very few external directors. On the other hand, British chairmen are typically outsiders. In contrast, US boards mostly have a majority of outside directors, but the chairman is usually an insider, either a past or current chief executive. German supervisory boards are required to have employee representatives, their number and proportion depending on the size of the company. In the other countries, labour representation and participation in firm decision making is rare, except where they are significant shareholders. State owned firms also tend to have higher labour representation.

Countries also vary in the extent to which major shareholders have board representation. In the USA and UK, large institutional shareholders have only very recently sought representation on boards. In contrast, in Germany, and France, it is the norm to have major shareholders, such as banks or institutional investors, sitting on the board. Boards with a majority of directors who represent shareholders are more likely

to globalize and they are less risk averse than boards dominated by nonshareholders because they will be less constrained by non-shareholder interests.

Hence, such firms are more likely to favor globalization strategies, particularly global market participation and global activity location, even if they adversely affect stakeholders. Similarly, such firms are more likely to use global management processes because they will seek value-maximizing behavior more than preservation of traditional, country centered methods.

The insider-outsider split probably has mixed effects on globalization. On the one hand, outsiders (unless they represent special interests) should be able to make the most neutral tradeoffs about the risks involved in globalization. Boards dominated by neutral outsiders should be less risk averse than boards dominated by insiders, because they do not have their shares or job security at stake. Outsider directors are more likely to favor globalization strategies, particularly global market participation and global activity location. On the other hand, insiders typically have motives of empire building and incentive pay to offset any inherent preference for the status quo. Hence, performance evaluation and reward are also critical.

Globalization should be affected by boards having *partial* members: representatives of employees, network partners, suppliers, customers, governments or non-governmental organizations (NGOs). Partial boards will bias decisions away from pure profit and shareholder value maximization, and hence the optimal globalization strategy, in favor of their particular constituencies. The employee, government and NGO board representatives pose might prevent fully-fledged globalization in order to promote their own interests. In contrast, representation of major shareholders, provided they have neutral interests, should favor globalization. Generally speaking, the other things being equal, neutral boards will be more likely to favor the right globalization strategies.

It seems that globalization strategies will be most facilitated by having boards that have *neutral* interests favoring shareholder value.

d) Top management teams

Top management teams vary across countries in terms of their mobility and their background. In general, we expect that top management teams comprising mobile, professional managers are more likely to globalize. The more important distinction is whether the top management team acts in a *fiduciary* as opposed to an *autonomous* basis.

Top managers with lifetime employment in the firm are more likely to act as fiduciaries for stakeholder interests and be more conservative about globalization. Similarly, those top managers who view themselves as professional managers rather than as specialists in a function are also more likely to make the balanced assessments needed for globalization. It is expected that companies with mobile, professional top management team will favor all elements of global strategy and organization, and adopt the most aggressive globalization strategies.

e) Governments

Governments can intervene in a business in two main ways:

- first, they set the general rules and regulatory regimes that apply to all companies in a country or all companies within a given category. These rules and regimes also typically distinguish between domestic and foreign firms, and between domestic activities and foreign activities. For example, there may be general rules about the export of jobs and the import of foreign labour, or about the closing of operations;

- second, governments may intervene in individual cases, such as whether to allow a particular company to be sold to a foreign buyer.

Governments have many interests to motivate their behavior. In the case of globalization, the two most important interests are probably the enhancement of national competitiveness and the preservation of employment. Both interests are likely to conflict with corporations' free pursuit of globalization, especially in the short term. In general, corporations seek to ignore country considerations if at all possible in their globalization decisions, while national governments will inherently seek to intervene in favor of their country.

Countries differ in the degree to which their governments intervene in the affairs of corporations, for ideological, political and legal reasons.

The relationship between interventionist governments and global strategy is also important. Interventionist governments are more likely to encourage *global market participation* so long as jobs are not exported.

They will also prefer exports as the mode of market participation rather than the setting up of overseas subsidiaries. They should in theory favor the development of globally successful *products and services*. In practice, protection often, but corporations to *locate* activities globally outside the home country, usually to preserve employment.

Even liberal governments, such as that of the USA, can discourage some global relocation. Although they will probably be neutral as to whether domestic corporations use global as opposed to national *marketing*, such governments may have a slight preference for preserving aspects of national identity. Interventionist governments should make it harder for a corporation to make *global competitive moves*, as these often require sacrifice of home country position, resources, revenues or profits, and hence domestic jobs or working conditions.

As for the relationship between interventionist government and global organization, protectionist governments should:

- favor *global organization structures* so long as the home country is dominant;
- favor *global management processes* so long as the home country processes dominate;
- make it harder for a corporation to have *global human resources policies*, as they will favor the employment and advancement of home country nationals;
- make it harder for a corporation to implement a global, rather than home country, *culture*.

Conclusion

The above analysis underlines that strong roles for each corporate governance's actor predict particular globalization models. Besides, in order to understand corporate behavior such as globalization strategies, it is necessary to comprehend the dynamics of the different actors related to the firm: employees, shareholders, the board of directors, top management teams, and government.

When firms need to grow, managers have different diversification choices. If they choose to tap into other markets through geographical diversification, then they should be aware of the actor-centered institutional factors that will determine their globalization decisions. Understanding the institutional environment within which firms operate at the national level will allow managers to align the different actors' interests and capabilities with their own firms' globalization modes.

To a large extent the corporation's behavior was described as favoring globalization – risk taking, willingness to change, long-term maximization of profits and shareholder value and neutrality toward domestic national interests – is also the same as that favoring the long-term health and competitiveness of a nation's companies. Hence the national corporate governance systems that favor globalization also favor long-term corporate competitiveness.

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